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LS-732

OGC HAS REVIEWED.

24 July 1951

MEMORANDUM FOR: Deputy Director (Administration)

SUBJECT: [redacted] 25X1A

1. As I informed you orally, we have been engaged in a difficult negotiation with the [redacted] on a contract for the procurement of [redacted] for communications. The difficulties have arisen out of [redacted] demand for a 11.2% profit factor in the fixed-price contract, as well as a price redetermination clause on demonstration of increased cost. [redacted] has asked for a 25% upward revision limitation. The normal profit factor for such procurement is 10% with or without the upward revision clause on increased cost, and it appeared that the [redacted] proposal was extremely favorable to the company.

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2. [redacted] of my office has investigated the situation thoroughly and feels that unless we can drop the procurement with [redacted] entirely, we will probably have to accept their demands. According to Communications Division, dropping the procurement of this item and finding another producer would mean months of delay and failure to meet their procurement schedule. If this is so, the main interest in the case may be for study to eliminate similar situations in the future.

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3. Generally speaking, there is no limit fixed by law in Government procurement for the profit factor in fixed-price contracts, but normally 10% was regarded as the maximum for standard items. In fact, the Signal Corps and the Navy attempted to keep the profit estimate below 10% when the procurement is not difficult and requires no unusual technical know-how. In the [redacted] case, the [redacted] desired is fairly complicated but is a standard item and 10% would appear a proper profit factor for negotiation purposes. The 25% upward revision clause is also somewhat high, but as production is spread over two years, it is not too unusual. Together, however, the 25% spread and the 11.2% set profit gives [redacted] almost a guarantee of high profit on a standard item.

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4. One reason [redacted] was chosen for procurement was that they have an [redacted] which is patented and which is not, as far as the Communications Division knows, made by any one

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else. Consequently, discussions with [redacted] of our requirements have proceeded for some time and to drop the contract at this point in order to try to find another producer would consume at least several months and might not develop as satisfactory a transmitter. We may be faced, therefore, with what is in effect a sole source of supply which can insist on its own terms.

5. It should be noted that the Signal Corps has found itself in the same situation and has to our knowledge five contracts of this type with [redacted] one of which, we are informed, allowed 11.5% profit with an upward revision of 21% over 1½ years. This is a $13,000,000.00 contract and Signal Corps alone has at least $31,000,000.00 worth of procurement with [redacted] with a 11½% cost factor.

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6. [redacted] is a reputable and medium-sized producer which was built almost entirely on war-time Government contracts. It is financially stable and currently has almost capacity orders from the Government. It is therefore in a very strong bargaining position. Even Signal Corps with its large dollar value has been unable to negotiate favorable terms. Navy has done somewhat better through the fact that if it cannot get the terms it wishes, it will draw up its own specifications and look for other manufacturers. This requires a very large and competent technical staff and ample time in which to develop a producer.

7. It may well be that our only solution to avoid similar situations is to increase our sources of technical information and coordinate them with a negotiating procedure that will enable us to cover the production field more completely in an effort to avoid being faced with one source of supply which can set its own terms. Even then, if the [redacted] is required and is completely controlled through patents by [redacted] there might be no alternative to the single source of supply.

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General Counsel

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